Morale, Welfare, and Recreation: Declining Funds Require DOD to Take Action (Letter Report, 02/28/94, GAO/NSIAD-94-120).

The Pentagon's morale, welfare, and recreation program provides service members and their families with such services as commissaries, fast food restaurants, health clubs, and golf courses. The financial outlook for the program appears to be worsening. Exchange stores--the largest producer of program revenue and a source of money for other program activities--have seen revenues shrink since 1989. Defense downsizing and increased private sector competition are likely to further dampen program revenues during the 1990s. Appropriated funds, which now constitute about 10 percent of program funding, are also expected to decline along with overall budgets. Cuts in program services are likely unless changes are made soon. The Defense Department's (DOD) decentralized approach to managing the program--a $12 billion enterprise when exchanges are included--may not be well-suited to an environment of diminishing patronage and funding. Because individual commanders have broad discretion in allocating money at installations, funds from different sources become mixed, making it hard to know whether the program is providing the best mix of services with the least demand on taxpayer dollars. Also of concern are cash balances of more than $300 million at some Army installations. If not managed carefully, the money could be spent in ways that incur future costs and worsen finances in the long run. Program consolidation has been tried successfully by some of the services but has been resisted by others. A DOD strategic review of the program, a promising catalyst for change initially, appears to have stalled.

MWR
MORALE, WELFARE AND RECREATION

Provides services and sales to military members and civilian employees at discount prices.
These are things like a decrease in price on movie tickets, tours, concerts, etc.

They provide stores like grocery stores and small stores where the military can purchase televisions,
radios, socks, shampoo, plants, furniture, etc.

They provide on post child care centers.
They provide after school programs.
Some posts have a theater on them and they put on various events, concerts and shows.
They plan dances, places for people to hang out like video game rooms, clubs, bars.
They plan marathons, fairs, trade-events, etc.

They offer places to eat on post, small sandwich shops, hamburger shops, etc.
They do all sorts of things for the military and the civilian employees at a cost, but the money they make is a PROFIT.

Some posts have Gold Courses, airports, gyms, pools, etc.

All these things are NOT in the constitution - therefore it has to generate its own money to pay for itself.
These are the NON-APPROPRIATED FUND things.
This means the government does not allocate money for these things.
Government money is called APPROPRIATED.
MEANING CONGRESS HAS TO APPROVE THE FUNDS AND THE FUNDS MUST BE CONSTITUTIONAL.

Things NOT approved by the constitution is not paid for by the tax-payers. The money comes from NOT congress but from income derived from somewhere else.
The income comes directly from the people who partake in that service - the military and civilians pay for the things provided for by MWR.

MWR has consistently raised prices of its goods and services and the military and civil servants of the military have found it less expensive to go to the private places to get the same goods and services. By private places i mean places "off-post."
By "Post" i mean a military reservation.

Just because the business uses the word "welfare" and "welfare" is in the preamble does not mean that anything can be considered "welfare." The "welfare" are the things WITHIN the constitution.

-------------------------- Indexing Terms --------------------------

REPORTNUM: NSIAD-94-120
TITLE: Morale, Welfare, and Recreation: Declining Funds Require DOD to Take Action
DATE: 02/28/94
SUBJECT: Defense appropriations
Internal controls
Funds management
Sales
Program abuses
Military facilities
Budget receipts
Nonappropriated federal funds
Defense cost control
Post exchanges
IDENTIFIER: DOD Morale, Welfare, and Recreation Program

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Cover
== COVER

Report to the Chairman, Panel on Morale, Welfare, and Recreation, Committee on Armed Services, House of Representatives

February 1994

MORALE, WELFARE, AND RECREATION -
DECLINING FUNDS REQUIRE DOD TO
TAKE ACTION

GAO/NSIAD-94-120

Morale, Welfare, and Recreation

Abbreviations
== ABBREV

AAFES - Army and Air Force Exchange System
DOD - Department of Defense
GAO - General Accounting Office
MWR - Morale, Welfare, and Recreation
NSIAD - National Security and International Affairs Division

Letter
== LETTER

B-256548

February 28, 1994

The Honorable Solomon P. Ortiz
Chairman, Panel on Morale, Welfare,
and Recreation
Committee on Armed Services
House of Representatives

Dear Mr. Chairman:

The services the Department of Defense (DOD) provides its people through the morale, welfare, and recreation (MWR) program constitute a multibillion dollar business. Yet, apart from sheer size, the analogy with big business is not a good one. Except for the exchange stores, the MWR program is really a collage of individual activities that are managed at the installation level. The former Chairman asked us to review the program as it adapts to reductions in military force structure, budgets, and bases. Specifically, this report addresses MWR's financial status, the problems facing the program's management, and actions DOD is taking or contemplating to improve the program's operation.

BACKGROUND

-- Letter :1

The MWR program provides service members, their dependents, and eligible civilians with an affordable source of goods and services like those available to civilian communities. For those eligible, DOD provides activities such as retail outlets, fast food operations, clubs, libraries, gymnasiums, golf courses, and family recreation facilities. DOD intends for the MWR program to go beyond providing basic needs to making individuals more satisfied with military life and attracting people to military careers. MWR programs operate on military installations and receive financial support primarily from two sources--nonappropriated funds, generated from revenue, and appropriated funds.

DOD classifies MWR activities into three categories, which receive various degrees of appropriated funds (see app. I). Category A includes mission-sustaining activities, such as athletic fields, gymnasiums, and libraries that are to be supported primarily with appropriated funds and that are generally not expected to generate revenues. Category B activities, such as swimming pools, automotive hobby shops, and child care centers, generate some revenue but still receive a significant amount of appropriated funds. Category C activities, such as golf courses, bowling alleys, and movie theaters, are expected to generate revenue and to be primarily self-supporting. Commissaries, or food stores, are also technically considered part of the MWR program. However, we did not include them in our review because the services manage the commissaries separately and the revenue generated from the stores is not shared with other MWR activities.

RESULTS IN BRIEF

-- Letter :2

The financial outlook of the MWR program appears to be worsening. Exchange stores--the largest producer of MWR revenue and a source of dividends for other MWR activities--have experienced declining income since 1989. Revenue generated by MWR activities is likely to decrease in the 1990s because of the downsizing of forces and increasing private sector competition. Appropriated funds--which now constitute 10 percent of MWR funding--are also expected to decline as overall budgets decline. If changes are not made soon, the declining financial conditions are likely to force reductions in the services the program provides.

DOD's decentralized approach to managing the MWR program--a $12-billion enterprise when exchanges are included--may not be well-suited to the receding patronage and funding the program now faces. For example, some category C activities are not making money and some base commanders feel that other programs, such as child care, demand too large a share of MWR funds. Because of each individual commander's discretion in allocating money at the installation, funds from different sources become mixed. This hampers accountability for and analysis of individual activities and makes it difficult to know whether the MWR program is providing the best mix of services with the least demand on taxpayers' money. Also of concern are cash balances of over $300 million Army installations have accumulated. This money does not necessarily represent profits generated by the installations themselves, but funds distributed from different sources. If not managed carefully, the money could be spent by installations in a way that incurs future costs and worsens finances in the long run.

Many of these problems are well-known, and different remedies have been studied, most of which involve sacrificing some installation-level flexibility to improve financial management. A common conclusion of such studies is that the MWR program is too fragmented and needs to be consolidated. Indeed, the consolidation of the Army and the Air Force exchanges appears to be a success and is being followed by the consolidation of the commissaries. However, the Navy and the Marines have resisted further consolidation and prefer to engineer their own vertical mergers of exchanges and other MWR activities. Regardless of whether consolidation emerges as the best path for the MWR program, it is clear that significant changes in the program are necessary to improve the efficiency of services. Until recently, a strategic review of the MWR program conducted by DOD offered promise of serving as the catalyst for such changes. However, after 2 years in the making, it appears that the review has stalled and will not foster the needed changes in time.

FINANCIAL STATUS OF THE MWR PROGRAM

-- Letter :3

Revenues from exchange stores and other MWR activities supply about 90 percent of MWR funds, while appropriations supply the remaining 10 percent. The amount and sources of funds available to MWR activities in fiscal year 1992 are shown in table 1.

Table 1

Amount and Sources of Funds Available to MWR activities in Fiscal Year 1992

(Dollars in millions)

Sources of Funds	Amount	Total
Revenues		
Exchanges	$9,322.2	
Other MWR activities	2,025.8	
Subtotal		$11,348.0
Appropriated funds		
Exchanges	$ 246.9	
Other MWR activities Subtotal	1,018.0	1,264.9
Total MWR funds available		$12,612.9

Source: DOD.

Over the past 6 years, MWR revenues and appropriations have been stable enough to avoid precipitous cutbacks in MWR activities. However, the financial picture is worsening. Dividends from exchange stores have been declining since 1989, and could continue to fall as military force levels decline. Similarly, the amount of appropriated funds the services can devote to MWR activities is likely to decline as competition for funding within smaller service budgets intensifies.

EXCHANGES' FINANCIAL CONDITION IS KEY TO THE MWR PROGRAM

-- Letter :3.1

The continued financial health of the exchanges is clearly critical to the viability of the MWR program. The exchanges not only provide merchandise and services at reasonable prices to the military community worldwide, but are counted on to make a profit to help defray the cost of other MWR activities, easing the burden on the need for appropriated funds. The exchange system also provides services such as uniform sales stores and school lunch programs. These services would otherwise require appropriated money to provide.

Three separate exchange systems operate within DOD. The Army and the Air Force operate the consolidated Army and Air Force Exchange System (AAFES), while the Navy and the Marine Corps operate their own exchange stores. With total revenue from sales, concessions, and other sources of over $6.5 billion in fiscal year 1992, AAFES is about three times the size of the Navy Exchange System, which had a total revenue of over $2 billion. The Marine Corps exchanges generated $536 million in revenue during fiscal year 1992.

During fiscal years 1987 through 1992, the exchanges were continuously profitable and paid dividends to the MWR program. During that period, net income for AAFES and the Navy Exchange System amounted to about 5 percent of sales, over half of which was paid to other MWR activities in the form of dividends. Because the Marine Corps merges the financial information for its exchanges with its other MWR activities, its data is not comparable with AAFES and the Navy exchanges. Even though the exchanges are profitable, they are subsidized with appropriated money for expenses such as military personnel, overseas transportation of goods, and certain utilities and minor construction. This subsidy was about $247 million in fiscal year 1992, approaching the amount of dividends--$305 million--the exchanges paid to MWR activities in that year.

As shown in figure 1, the net income and dividends from AAFES and the Navy Exchange System have declined gradually since fiscal year 1989. Although the Marine Corps has begun to develop comparable data on its exchanges, such data is not available for past years.

Figure 1: AAFES and Navy
Exchange Net Income and
Dividends Paid to MWR
Activities (Constant Fiscal
Year 1992 Dollars)

(See figure in printed
edition.)

Source: GAO analysis of DOD data.

According to Navy officials, Navy stores were hit harder by a general economic downturn in 1990. While both exchanges' net income decreased in fiscal years 1991 and 1992, the Navy's decreased substantially more in 1991--19 percent compared to AAFES' 2 percent. Both exchanges' net profit decreased about the same in fiscal year 1992, about 9 percent. The financial condition of the Navy's exchanges was compounded by the fact that during these years, the stores paid out over 90 percent of net income in dividends to MWR activities--compared to over 60 percent for AAFES--leaving less money to reinvest in equipment and facilities. The Navy exchanges agreed to do this to enable the Navy to use more of its appropriated funds for mission-specific purposes, such as ship upkeep, than for MWR programs. The Navy has since decided to lower the amount of such dividends and successfully sought an increase in fiscal year 1994 appropriated funds for MWR programs.

For several reasons, exchange dividends are not likely to rebound over the next few years, and may even decline further. Perhaps the most visible reasons are the force structure reductions and base closure actions that will continue to occur over the next several years. In addition, an August 1993 study by the Logistics Management Institute cites the increasing competition from the private sector, noting that "Price clubs and discount stores have eroded the price advantage that AAFES has traditionally held."\1

However, exchange system officials believe that the exchanges' financial condition will be strong if they aggressively streamline operations.

\1 Strategies to Improve the Financial Status of Army Recreation Business Programs (AR208R1, Aug. 1993, Logistics Management Institute).

FINANCIAL CONDITION OF OTHER MWR ACTIVITIES IS WEAK

-- Letter :3.2

MWR activities other than the exchanges collectively do not produce enough revenue to cover their expenses. For example, for fiscal year 1992, these activities produced $2,025 million in revenue, but required $1,018 million in appropriations and $305 million in dividends to cover expenses. Because these activities represent all three categories of the MWR program, they are not all expected to turn a profit, nor would it be reasonable to expect that collectively they would compare favorably with the financial condition of the exchanges. However, the financial status of the category C activities--those intended to make a profit--appears worse than that of the exchanges. According to the Logistics Management Institute study, among the Army's primary category C activities--bowling centers, golf courses, and clubs--only the golf courses show a profit (about $2.3 million in fiscal year 1991). Even when appropriated funds are counted as income, the bowling centers and clubs do not show a profit.

Without significant improvements in operations or increased appropriations, these other MWR activities are likely to be cut back. The revenue produced by other MWR activities is likely to decline in future years for the same reasons exchange revenue and dividends are expected to decline. Compounding the loss of revenue is the expected reduction in appropriated funds. Funding for MWR activities must compete with other demands on DOD's budget, and the services expect MWR appropriated funds to decline as budgets decline. For example, the Army expects to reduce appropriations used for MWR activities by about 20 percent from fiscal years 1993 to 1994. Army officials expect appropriated fund levels to stay at least this low for the next few years.

Because MWR expenses may not fall as quickly as revenue, the gap between revenue and expenses may widen in the near term. The Logistics Management Institute attributes the latter phenomenon to the fact that overhead expenses will continue to be incurred after the customer base begins to decline. Thus, unless MWR expenses can be reduced through sound financial decisions, activities will have to be curtailed because MWR is not likely to receive a larger share of appropriated funds.

OTHER MANAGEMENT PROBLEMS CONFRONTING THE MWR PROGRAM

-- Letter :4

Unlike exchanges, other MWR activities operate under a decentralized management philosophy. Decisions on how to run individual activities and how to spend revenue, dividends, and appropriated funds are made by installation commanders. While the decentralized approach provides the flexibility to tailor MWR services to the individual needs of the services and installations, it also clouds oversight of how funds are being spent and how efficiently and effectively activities are being run. Perhaps the greatest challenge facing the MWR program today is providing quality services while ensuring effective stewardship of increasingly scarce financial resources.

MIXING OF FUNDS BLURS OVERSIGHT

-- Letter :4.1

Installation commanders have the flexibility to decide how to channel appropriated and nonappropriated funds to different MWR activities. A byproduct of this flexibility is that revenue, dividends, and appropriated funds are commingled at the local level, making it difficult to track which monies are funding which activities. From a management standpoint, this mixing of funds hampers the ability to identify which activities are doing well and which are not, making it difficult for the services to make hard business decisions. Thus, while a dedicated analysis can point out that the more lucrative category C activities are not making a profit, this information is not routinely visible to aid management of the MWR program. For example, it is difficult to target initiatives to improve the patronage and profitability of bowling centers if the fact that they are losing money cannot be readily determined.

Another byproduct of commingling MWR funds is the perception of inequity by service members. For example, most of the installation commanders we spoke with complained that they had to devote MWR revenue to cover child care program costs, even though the program receives appropriations through the Military Child Care Act of 1989 and collects fees from parents. The commanders noted that subsidizing child care causes resentment among those service members who do not benefit from the program but do patronize other MWR activities. Similarly, some service members have questioned the use of funds to subsidize officers' and other clubs on the basis that these clubs are not popular. Otherwise, the clubs would generate greater patronage and would not need subsidies.

In December 1993, we reported on another problem--abuse in DOD's recycling program--that further blurs the funding of MWR activities.\2 Specifically, we reported that millions of dollars were being used annually for MWR activities that should have been used instead to offset the need for appropriated funds or be returned to the U.S. Treasury. Military bases were routinely receiving money from the sale of aircraft, vehicles, and other materials that DOD policy specifically excluded from the recycling program and then were using the proceeds to fund MWR activities. In addition, some installations, without proper authorization, were holding their own sales rather than selling materials through disposal offices. Therefore, the total amount installations were receiving from the recycling program and spending on MWR activities was unknown.

\2 Department of Defense: Widespread Abuse in Recycling Program Increases Funds for Recreation Activities (GAO/NSIAD-94-40, Dec. 10, 1993).

SERVICES ALLOCATE APPROPRIATED FUNDS DIFFERENTLY

-- Letter :4.2

The individual services have a wide degree of latitude in how they channel appropriations to MWR activities. No separate line item appears in the DOD or service budgets for MWR activities. Instead, the services draw funds for their MWR programs from several appropriations--primarily the Operations and Maintenance and Military Personnel accounts. Consequently, differences exist between how the individual services distribute appropriated funds to MWR activities, as evidenced in the per capita variances shown in table 2.

Table 2

Per Capita MWR Funds Appropriated for Fiscal Years 1989 to 1992\a

Fiscal year	Army	Air Force	Navy	Marine Corps
1989	552	489	283	214
1990	559	529	293	230
1991	617	536	337	240
1992	523	577	342	263

\a These figures exclude appropriated funds for exchanges and military construction. The figures include indirect operating costs, including allocations of installations' overhead costs.

Source: DOD.

The differences among these figures illustrate the flexibility the services have in allocating appropriations to the MWR program, as well as the complexity in overseeing the program. The significantly lower numbers for the Navy and the Marine Corps indicate their decisions to spend more appropriated funds on mission activities than on MWR activities. While the services are free to devote what they consider the right amount of appropriations to MWR, it is difficult to tell whether the best decisions are being made. For example, DOD found it necessary to create a one-time, $10-million MWR line item for the Marine Corps in the fiscal year 1995 budget to compensate for the Marine Corps' traditionally low funding for the MWR program. On the other hand, the fact that the Air Force and the Army devote about double the amount of appropriations to MWR does not necessarily mean that their programs provide twice the level or quality of activities. The higher funding could mean that some activities are being funded in one service that another service charges for or that some are being run inefficiently.

We also found a wide range in the use of appropriated funds to support category A activities among the different service installations we visited. Such activities have the least ability to generate revenue. The Air Force installations we visited used about 75 percent of appropriated funds on category A activities, the Army installations used about 50 percent, and the Marine Corps units used only about 25 percent. The mix of appropriated and nonappropriated funds used to support category B activities also varied greatly among the installations we visited. We generally found the funding of category C activities to be more consistent, with most installations using less than 10 percent of appropriated funds to support these activities.

ARMY CASH LEVEL MANAGEMENT

-- Letter :4.3

Another problem concerning the MWR program is the high level of nonappropriated cash balances being held, particularly by Army installations. The Army has made some progress in reducing this balance--as of September 30, 1992, the Army had an MWR cash balance of $458.4 million and as of September 30, 1993, the balance was $385.9 million. Most of this balance--$310.2 million--was being held at the installation level. Table 3 shows the planned use of the installations' cash balance, as of September 30, 1993.

Table 3

Planned use of Army Installation Level MWR Cash Balance

(Dollars in millions)

Item	Amount	Total
September 30, 1993, cash balance		$310.2
Less:		
Liabilities	$122.5	
Contribution to major construction fund	30.0	
Minor improvements and construction	108.0	
Subtotal		260.5
Unencumbered cash		$49.7

Source: U.S. Army.

The cash balance has raised several concerns. First, at the same time most of the cash is being held at installations, Army headquarters needs more money to finance centrally managed construction projects. Second, individual installations could obligate funds for minor capital improvement and construction projects that in the long term are unaffordable or not good investments. Third, installations may hold unnecessarily high balances to earn interest rather than to distribute the money to individual MWR activities. Also, the cash itself does not necessarily represent profit. Thus, while its sources are nonappropriated (such as from dividends and MWR revenue), the balances exist partly because appropriated funds defray a portion of the installations' MWR costs.

The Army recently developed a financial plan to reduce nonappropriated cash balances. Some of the changes involve (1) reducing the amount of AAFES dividends and recreation machine (slot machine) trust fund profits distributed to installations; (2) paying interest on installation deposits in the fund only on the first $1 million, to discourage large cash balances at the installation level; and (3) enforcing a set of financial standards for installation MWR activities designed to improve business management. The standards call for all appropriated funds to go to category A activities, for category B activities to break even, and for category C activities to make a profit. Army officials have established a goal to close those category B and C activities that do not meet the standards by 1995.

TRUST FUND PROFITS

NON-APPROPRIATED -- NOT CONSTITUTIONALLY APPROVED

APPROPRIATED - CONSTITUTIONALLY APPROVED

CONSOLIDATIONS AND OTHER PROPOSED REMEDIES

-- Letter :5

Potential solutions to the MWR program's long-standing problems have been studied and proposed for a number of years. A remedy frequently recommended has been horizontal consolidation of like MWR activities, particularly service exchange stores. Another solution, preferred by the Navy and the Marine Corps, is a complete or partial vertical merger of MWR activities within each service. The August 1993 Logistics Management Institute study also proposes contracting out of some MWR activities to the private sector.

One element common to these solutions is the recognition that some flexibility at the local level will have to be sacrificed to improve the financial outlook for the MWR program. While an argument can be made that local flexibility is critical to tailoring MWR activities to the needs of a particular installation community, the poor financial results of these activities suggests that such flexibility has not produced results. On the other hand, any changes in MWR management that would result in the loss of local flexibility must be attentive to the unique needs of remote installations that do not necessarily have commercial alternatives to MWR services.

LONG-STANDING CONSOLIDATION AND COOPERATION ISSUES

-- Letter :5.1

Since 1968, studies by DOD, our office, and others have recommended the consolidation of exchanges into a single entity. While Army and Air Force exchanges have consolidated under AAFES, the Navy and the Marine Corps retain independent exchanges. Although a 1990 study again predicted financial benefits would be achieved through consolidation, DOD decided against further consolidation of the exchanges at that time, partly because of opposition by the Navy and the Marine Corps. However, DOD and the services did take other steps to consolidate and improve the operation of MWR activities.

According to AAFES officials, consolidation of all exchanges would be beneficial and a phased consolidation should be done. Navy and Marine Corps officials, however, remain strongly against it because of the significant start-up costs associated with consolidation and possible loss of the savings they are attempting to achieve through their vertical merging of MWR and exchanges and other initiatives. They also believe that the current systems are a more efficient, customer-oriented operation because of the decentralized control and entrepreneurial spirit generated by the independent exchanges.

The Marine Corps, on its own initiative, merged its MWR activities with its exchange system in 1988, and the Navy has tested a similar merger at two installations. Since the merger, the Marine Corps has reported cost savings totaling $4.3 million. Initially, problems were encountered in merging the systems; however, Marine Corps officials believe most problems have been resolved or are in the process of being resolved. A key lesson learned was that even though the Marine Corps exchange and MWR activities are relatively small, the merger took several years to accomplish. The 5 years experience with the merger provided time for change to occur gradually--allowing managers to adjust systems and operations to assure a more efficient and effective transition.

In 1991, the services consolidated their commissaries under the Defense Commissary Agency. Despite many start-up problems, the new agency realized a savings of about $7.6 million in fiscal year 1992. The agency projects cost savings will reach $90 million by the end of fiscal year 1995.

Many of the problems experienced in the consolidation can be attributed to the 1-year timetable allotted for completing the consolidation instead of a more reasonable period of 3 to 5 years. The shortened timetable contributed to accounting and inventory systems incompatibility problems. Also, planning for personnel requirements was inadequate, and experienced personnel either found other jobs or were prematurely released. According to the managers of the commissary consolidation, key lessons learned were the need for (1) an adequate time-phased transition period to integrate systems and (2) a competent, experienced merger management team in charge of the effort.

Instead of consolidating the exchange systems in 1991, DOD directed the military services to initiate cooperative efforts to increase efficiencies, encourage competition, standardize certain functions to allow for comparisons among the exchange systems, and to improve patron service. Cooperative efforts include common use of AAFES-developed restaurant chains, joint use of equipment and supplies contracts, and store swapping. This latter effort involves the Navy running an AAFES store in an area dominated by Navy installations in return for AAFES running a Navy store in an area dominated by Army or Air Force installations. Also, financial reporting formats are being standardized and a standardized financial year-end report for 1992 is being tested.

A 1991 Logistics Management Institute study DOD relied on in deciding to delay consolidation of the exchanges advised that cooperative initiatives represented some of the first steps needed to be taken toward consolidation if that route where chosen later. According to the study, the initiatives would significantly reduce the business risks of full consolidation if it was undertaken at a later time. The study advised DOD not to make a decision on consolidation for another 3 years. By then, the study projected that the cooperative efforts should be completed, giving decisionmakers a much better basis to compare exchange operations.

As those years have passed, DOD has begun to feel the effects of force structure reductions and base closures. Further studies of exchange consolidation are probably unnecessary and a decision on whether to consolidate should be made soon. Navy officials stated that they have committed or are about to commit substantial funds to reorganize and upgrade their operations, as well to staff their new headquarters location. They believe that continued uncertainty about the exchange system's future hampers these efforts.

LOGISTICS MANAGEMENT INSTITUTE STUDY

-- Letter :5.2

In August 1993, the Logistics Management Institute completed an Army-requested study of alternative management structures for revenue-generating (category C) MWR activities. The study found that, based on generally accepted accounting principles, the Army's MWR business programs lost $72 million in fiscal year 1991. Thus, these activities were using, rather than generating, funds.

The Institute assessed the advantages and disadvantages of four management options to improve the financial status of the Army's MWR business programs. As requested by the Army, the study does not recommend any course of action. The options evaluated were

- retaining the status quo with enhancements such as creating a professional career track for managers, adopting private sector financial performance standards, and removing government impediments such as daily inventories;
- centralizing MWR management under a business activity center to minimize overhead at the installation and command levels, while making enhancements such as in the first option;
- transferring MWR business activities to AAFES to eliminate overhead without incurring the cost of a new organization, such as a business activity center; and
- contracting out some business activities under public-private ventures.

The study estimates that all four options offer savings to the Army, ranging from at least $20 million annually for the enhanced status quo to over $100 million annually for the business activity center. The Army believes these savings estimates are optimistic and that some of the study's methodology is inconsistent. Nonetheless, the Army is reviewing the alternatives in the study and is using the study as the impetus to develop a plan for both the structure of MWR and the future of MWR business programs. The Army has formed a task force to recommend a course of action to the MWR Board of Directors.

DOD STRATEGIC MWR REVIEW HAS BECOME INACTIVE

-- Letter :5.3

Since 1991, DOD has been conducting a strategic review of the MWR program to eliminate inconsistencies from service to service and to improve program oversight. Other objectives of the review include (1) refining the criteria for use of appropriated funds to support MWR activities and (2) developing standards and procedures for oversight and fiduciary responsibilities, financial management, and construction programs. At the close of our review, we learned that the strategic review group did not meet all of its objectives and was no longer convening. As a result, a revision to DOD's MWR regulation that has been in draft form for 3 years has not been issued.

One change DOD was considering was reducing MWR activity categories from three to two. One category would have consisted of core or mission essential activities supported only with appropriated funds. The core programs are those activities needed to meet mission readiness requirements, such as physical fitness. The second category would have included all other MWR activities to be supported exclusively from nonappropriated funds generated from the sales of goods and services. Included would be revenue-generating activities such as exchanges and golf courses, along with community-type services such as swimming pools. In essence, the second category would combine the activities currently included in categories B and C. However, at the conclusion of our review, a DOD official said DOD no longer plans to change to a two-category system.

SALE OF
"GOODS AND SERVICES"
NOT GOVERNMENT.

We believe the two-category system has merit since it would (1) provide oversight and top-level responsibility for the mission essential activities to be funded by appropriated money and (2) eliminate the mixing of appropriated and nonappropriated funds between different categories. Further, by relying solely on revenues, management of the noncore community service activities would likely be encouraged to more closely focus on their need based on usage and to employ business practices that would minimize cost and attract more customers.

RECOMMENDATIONS

-- Letter :6

We recommend that the Secretary of Defense establish milestones for the completion of the strategic MWR review and the implementing guidance (1) to improve the management and oversight of the MWR program and (2) to ensure that the services have sound management strategies that anticipate the likelihood that MWR funding will decline faster than costs.

The Army faces the competing challenges of managing the (1) liquidation of a large cash balance, (2) improved performance of category C business activities, and (3) reduction in the reliance on appropriated funds. Accordingly, we recommend that the Secretary of the Army delay the further obligation of funds for MWR capital improvement and construction projects until such projects are shown to be sound investments, affordable, and consistent with the need to be less reliant on appropriated funds in the future. To the extent such projects do not prove to be the best use of funds, we also recommend the Secretary redirect the funds to efforts that will increase MWR profits or lower MWR expenses.

SCOPE AND METHODOLOGY

-- Letter :7

To answer questions regarding DOD's MWR policies, we reviewed (1) DOD's guidance and directives related to MWR management and funding and (2) the services' guidance and directives on the operation of installation MWR programs. We also interviewed officials in the Office of the Secretary of Defense responsible for the MWR program. We interviewed program officials for each of the services and each of the exchanges.

To assess the financial status of the exchange systems, we reviewed and compared audited financial statements of the three exchange systems for fiscal years 1988 through 1992. Because the Marine Corps financial statements merge exchange and MWR operations, we concentrated our comparison on the financial performance of the Army and Air Force and Navy Exchange systems. We also interviewed officials at all three exchange systems, external auditors of the Navy Exchange Command, and an industry analyst.

The individual services provided data on the per capita amount of appropriated funds each service distributes to MWR activities. The data was consistent regarding (1) the standard expense categories each service reports to the Office of the Secretary of Defense and (2) the use of average military end strengths as the base in computing the per capita amounts. However, we did not verify the accuracy of the data provided.

To obtain information on base-level MWR management and operations, we visited the services' exchange headquarters in Staten Island, New York, and Dallas, Texas, as well as 24 service installations. At each of the 24 bases, we observed operations of MWR activities and interviewed commanders and other MWR officials.

We conducted our review from December 1991 to December 1993 in accordance with generally accepted government auditing standards. As requested, we did not obtain official agency comments. However, we discussed the results of our work with responsible agency officials, and we have incorporated their comments where appropriate.

-- Letter :7.1

We are sending copies of this report to the Chairmen, House Committees on Armed Services, on Appropriations, and on Government Operations, and Senate Committees on Armed Services, on Appropriations, and on Governmental Affairs; the Secretaries of Defense, the Army, the Navy, and the Air Force; the Commandant of the Marine Corps; and the Director of the Office of Management and Budget. We will also make copies available to others upon request. Please call me or David Warren, Associate Director, on (202) 512-8412 if you or your staff have any questions. Other major contributors are listed in appendix II.

Sincerely yours,

Donna M. Heivilin
Director, Defense Management
and NASA Issues

CATEGORIES OF MORALE, WELFARE, AND RECREATION ACTIVITIES

== Appendix I

CATEGORY A

-- Appendix I:1

Libraries
Sports and athletics
Recreation centers
Free admission motion pictures for isolated or deployed units
Armed forces professional entertainment overseas
Unit level programs
Parks and picnic areas

CATEGORY B

-- Appendix I:2

Arts and crafts
Auto crafts
Entertainment (music and theater)
Outdoor recreation
Swimming pools
Youth sports activities
Child development
Bowling lanes (12 lanes or less)
Information, tickets, and tours
Marinas (without resale)
Skeet and trap ranges

CATEGORY C

-- Appendix I:3

Open messes
Golf
Bowling lanes (over 12 lanes)
Marinas/boating
Audio/photo resale
Riding stables
Rod and gun clubs
Aero clubs
Skating
Cabins and cottages
Armed forces recreation centers
Equipment rental
Scuba diving

MAJOR CONTRIBUTORS TO THIS REPORT

== Appendix II

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